IRAN, ISLAMIC REPUBLIC

Following moderate growth in 2015 related to uncertainties regarding implementation of the Joint Comprehensive Plan of Action (JCPOA), the Iranian economy is projected to grow at an average rate of 4.5 percent during 2016-18 as the benefits of the removal of sanctions materialize. The medium-term prospects depend on a sustained reform agenda and increased integration with the global economy.

Recent developments

Growth is estimated to have moderated to 0.6 percent in 2015 (March 2015 - March 2016), from 3 percent in 2014, in the run-up to the implementation of the JCPOA (January 2016). Since January, Iran is likely to have benefitted from an improvement in business and consumer confidence under the reform-oriented Rouhani government and as suggested by emerging preliminary agreements with foreign companies preparing to ramp up investments in the country. There are early indicators of a pick-up in economic activity, with an estimated 4.4 percent growth in the first quarter of 2016 (March-June), albeit primarily driven by the oil sector.

In parallel with the weak growth performance in 2015, the unemployment rate rose by 0.5 percentage point to 11.3 percent, partly driven by an increase in the labor force participation rate, which reached 38.2 percent in 2015, up from 37.2 percent in 2014. The structural imbalances in the labor market continue to be a challenge with sharp differences along the gender, age, and spatial dimensions.

Inflationary pressures continued to abate and year-on-year consumer price inflation came down from a high of 34.7 percent in 2013 to 11.9 percent in 2015 and further to 9.2 percent in June 2016. Still, the CBI's lending rates remained almost unchanged, following the maximum deposit rate cut from 20 percent to 18 percent in October 2015 leading to fairly restrictive real policy rates.

On the fiscal side, the central government deficit is estimated to have deteriorated by 0.4 percentage points to 1.6 percent of GDP in 2015, with the rise in revenue being more than offset by the concomitant increase in expenditures, particularly current spending. Iran's current account surplus also weakened from a surplus of 3.8 percent of GDP in 2014 to an estimated 2.3 percent of GDP in 2015, with a decline in non-oil exports being only partially offset by a fall in imports.

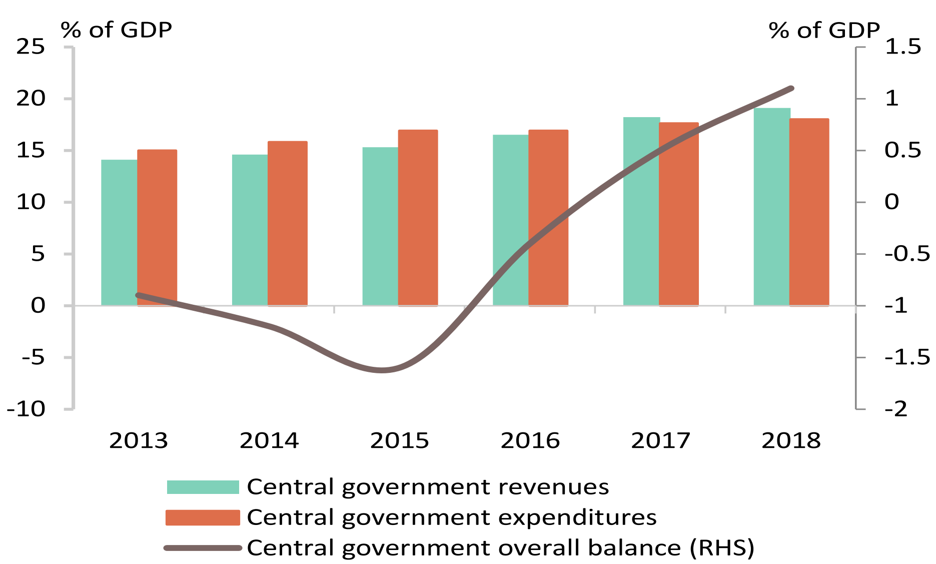
Outlook

Iran's economy is expected to grow at an annual average rate of 4.6 percent in 2016-18. Over the medium term (2017-2018), investment is likely to play a much larger role in generating growth on the assumption that new investment deals currently being negotiated will materialize in 2017 and 2018, and financial linkages with the rest of the world will be restored.

Meanwhile, inflation is expected to ease into single digits (8.6 percent) in 2016 for the first time since 1990 as a result of lower commodity prices and easing import costs in the wake of lifting of the sanctions, but could edge higher in 2017-2018 if oil prices recover.

The fiscal balance is projected to improve by 1.2 pp (percentage point) to -0.4 percent of GDP in 2016 as a result of an expected surge in the volume of oil exports and a parallel increase in non-oil revenues, and to move into surplus in 2017-2018. The current account surplus should

FIGURE 1 **Islamic Republic of Iran** / Central Government Operations (% of GDP)



start improving in 2016 and reach 4.1 percent in 2018 as increased energy exports more than offset the rise in imports stemming from lower trade costs and increased domestic consumption.

Risks and challenges

Iran's expected strong growth path is conditional on significant improvements in trade and investment linkages. Thus, a slower than anticipated implementation of the JCPOA may negatively affect this outlook. Also, Iran's dependence on the energy sector leaves it highly exposed to swings in gas and oil prices. Another major risk to the outlook is the potential outcome of the presidential elections scheduled for June, 2017. Continued commitment to implementation of significant structural reforms including of state-owned enterprises, of the financial sector and the management of oil revenues will play a crucial role in securing domestic and foreign investments alike. Finally, in the event of elevated geopolitical risks, the Iranian economy may be hit mainly through the trade channel. Better access to the extensive micro data and deeper analysis will be essential to accurately assess poverty and inequality trends.

TABLE 1 **Islamic Republic of Iran** / Macro outlook indicators (annual percent change unless indicated otherwise)

	2013	2014	2015	2016 f	2017 f	2018 f
Real GDP growth, at constant market prices	-1.9	4.3	1.7	4.6	5.2	4.8
Private Consumption	-9.3	3.1	3.9	2.4	3.2	3.0
Government Consumption	1.6	2.7	-8.9	-1.3	9.1	8.5
Gross Fixed Capital Investment	-6.9	3.5	-1.0	2.8	7.7	6.9
Exports, Goods and Services	0.0	12.0	6.3	22.7	17.5	12.0
Imports, Goods and Services	-18.7	-5.7	-5.6	18.2	23.6	14.6
Real GDP growth, at constant factor prices	-1.8	3.0	0.6	4.3	4.8	4.5
Agriculture	4.8	3.8	3.0	3.5	4.1	6.7
Industry	-4.7	4.9	4.2	6.5	6.7	4.8
Services	-0.6	1.7	-2.0	2.9	3.5	4.0
Inflation (Consumer Price Index)	34.7	15.6	11.9	8.6	10.4	9.1
Current Account Balance (% of GDP)	6.3	3.8	2.3	2.6	3.4	4.1
Fiscal Balance (% of GDP)	-0.9	-1.2	-1.6	-0.4	0.5	1.1
Debt (% of GDP)	1.6	1.3	0.9	0.7	0.5	0.4
Primary Balance (% of GDP)	-0.9	-1.1	-1.5	-0.4	0.6	1.1

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.
Note: f = forecast.